



March 25, 2010

Shawn Atlow
District Representative (Acting)
Los Angeles Unified School District
333 S. Beaudry Avenue
Los Angeles, CA 90017

Dear Ms. Atlow:

The Office of Public School Construction is entrusted with verifying that school districts meet specific criteria based on the eligibility for funding which is being requested. The OPSC works with school districts to assist them throughout the application process and ensures that the funds are allocated appropriately. To exercise this critical responsibility, the OPSC has the authority to audit expenditure reports and other district reports to ensure program compliance as stated in the Education Code and the School Facility Program Regulations.

Enclosed is the OPSC's completed audit of the Los Angeles Unified School District's (LAUSD) tracking and expenditure of savings from completed School Facility Program projects. The audit included a review of Comprehensive Annual Financial Reports, expenditures of savings, internal controls related to the capital facilities funds, source documents supporting expenditures, general ledger entries and balances, and reports of savings expenditures.

In summary, its findings include the following:

- A total of \$57 million in savings from 103 projects was initially improperly tracked in its General Ledger, and LAUSD has now established accounting methods that will show expenses and savings by project.
- Of the 103 identified projects in the audit, the LAUSD has not applied the savings from 87 projects to other high priority capital needs projects in the district. Though, there is no regulatory or statutory time limit as to when savings needs to be spent, the LAUSD has agreed to set up an accounting structure to better track the savings.
- LAUSD transferred \$6.5 million from district accounts that hold state appropriated funds to local debt service. As the audit recommends, LAUSD has agreed to transfer the funds back to the original accounts.

Further, the audit recommends that the LAUSD complete its reporting activity for all 103 identified construction projects, including postings, and savings expenditure procedures, as LAUSD stated to do so in December 2009. The audit also recommends that the LAUSD ensure that district staff is educated on the proper procedures for identifying, tracking, and reporting expenditures of project savings.

The enclosed final report is for your information and use. We have updated the final report from the draft report based on your response and other additional information received. Your response to the findings has been attached to the final report. In accordance with OPSC's policy of increased transparency, the final report will be placed on the *Reporting Transparency in Government* website.

We greatly appreciate the assistance and cooperation of the District's staff throughout the audit. Going forward, the OPSC values its relationship with the LAUSD and looks forward to assisting the district in maximizing its construction bond funds for future projects.

Should you have any questions concerning this matter, please contact me at rick.asbell@dgs.ca.gov or (916) 322-0317.

Sincerely,



RICK ASBELL
Operations Manager, Fiscal Services
Office of Public School Construction

RA:si

Enclosure

cc: Margaret E. Brown, Director, Facilities Program Management, LAUSD
James Sohn, Interim Chief Facilities Executive, LAUSD
Ramon C. Cortines, Superintendent, LAUSD
Rob Cook, Acting Deputy Director, Department of General Services
Lisa Silverman, Acting Executive Officer, Office of Public School Construction

Project file

Savings Audit Report

Report on the Los Angeles Unified School District Reporting and Application of Project Savings

Prepared By:
Office of Public School Construction
State Allocation Board

March 2010

Background

The School Facility Program (SFP) was implemented following the passage of the Leroy F. Greene School Facilities Act in November, 1998. Under this Act, the State Allocation Board (SAB) is responsible for the allocation of proceeds from General Obligation Bond Issues and other designated State funds to be used for the construction, modernization and maintenance of local public school facilities. The SFP provides funding grants for school districts to acquire sites, construct new school facilities, or modernize existing school facilities. The funding types are either for new construction, which provides funding on a 50/50 State and local match basis, or modernization, which provides funding on a 60/40 State and local match basis (for application filed after April 29, 2002) or 80/20 (for applications filed prior to April 29, 2002). If a district is able to provide less than the full local match requirement, they may be eligible to receive additional funding through the Financial Hardship program.

The Office of Public School Construction (OPSC) has the responsibility for verifying that school districts meet specific criteria based on the eligibility for funding which is being requested. The OPSC works with school districts to assist them throughout the application process and ensures that funds are allocated properly and in accordance with SFP regulations.

The OPSC has the authority to audit expenditure reports and other district reports to ensure compliance with program requirements contained in Chapter 12.5 of the Education Code and SFP regulations. The OPSC performs audits on school districts, county offices of education, joint use, and charter school districts.

California Education Code Section 17070.63 requires the application of project savings from SFP funded new construction and modernization projects to other high priority capital facility needs. California Education Code Section 17076.10 (a) states that "A school district that has received any funds...shall submit a summary report of expenditure of state funds and of district matching funds annually until all state funds and district matching funds are expended, and shall then submit a final report to the board."

Under the former State School Building (SSB) Lease Purchase Program (LPP), the State Lease Purchase Fund was established for reimbursement of district expenditures and proceeds were intended for expenditure on the direct construction costs of authorized projects per Education Code Section 17036(a). Any savings was returned to the state. Although the program is now inactive, projects funded under the LPP transitioned into SFP projects after November 1998 and districts still maintain balances within the fund for settlement of outstanding LPP issues.

From 1998 through July 2007, the OPSC conducted closeout desk reviews of 149 completed Los Angeles Unified School District (LAUSD) SFP funded new construction and modernization projects. LAUSD reported savings on 103 projects with a total savings of approximately \$57 million. The district's representative stated that the savings were in the process of being allocated to other projects and that the information would be reported to OPSC in the future.

OPSC closed the audits based on this statement and notified LAUSD that a savings audit would be performed in August 2007 (deferred until October 2007 at LAUSD's request) and requested that LAUSD provide details as to the status of the savings from the 103 projects. OPSC reduced the request for detail to 16 projects for the October 2007 audit as LAUSD stated they would be unable to provide details on all 103 projects prior to that specified date. The OPSC continued to provide the district time extensions in order to produce sufficient documentation. The information provided was difficult to understand and appeared to back date the use of savings to projects preceding the projects that generated savings. The OPSC conducted a follow-up visit with the district on February 4, 2009 which also proved to be unproductive.

After a series of letters, phone conversations, e-mails and meetings spanning two and a half years, the OPSC and LAUSD agreed to a field visit on July 21, 2009.

Scope and Objective

The objective of the audit was to gain an understanding of LAUSD's procedures related to the use of project savings, verify compliance with SFP statutes and regulations and other relevant criteria, and test supporting documentation for savings expenditures. In order to design adequate procedures to evaluate compliance, we gained an understanding of internal controls over the capital facilities funds and reviewed prior comprehensive annual financial reports.

Methodology

To determine the procedure in place for applying savings to other capital projects, verify compliance of savings application with SFP statutes and regulation, and verify an audit trail. As a result, we performed the following procedures:

- Interviewed key personnel;
- Gained an understanding of the tracking and allocation of savings to other projects;
- Reviewed General Ledger entries;
- Reviewed prior Comprehensive Annual Financial Reports (See Finding 2);
- Traced reported savings expenditures to the General Ledger;
- Tested savings expenditures by reviewing supporting documentation to verify compliance with SFP regulations; and
- Tested the allocation of interest to SFP projects and savings

The results of the audit are based upon our review of documentation and other information made available to us.

Results

Prior to this audit, the district had not created General Ledger accounts for the accumulation and expenditure of savings from state funded projects. Before fieldwork began, the district began creating accounts for savings (and accumulated interest) and populating the accounting system with the raw data. This procedure has not been fully applied to the identified 16 projects as all

postings to accounts are not fully complete. The district stated it plans to complete all activities and postings by December 31, 2009. In short, SFP project savings has not been accounted for during the ten plus years that the program has been in existence.

LAUSD has not applied the savings from the remaining 87 projects to other priority capital needs projects. LAUSD stated they should have the postings completed by December 31, 2009.

Additionally, our review of financial reports disclosed inappropriate fund transfers which are discussed in the second finding.

The audit produced two reportable findings as follows:

Finding 1

Until early 2009, LAUSD did not have a procedure in place for identifying uses of projects savings, tracking savings expenditures, or reporting uses of savings. The district reported approximately \$57 million in savings from 103 projects but had not accounted for the savings in the General Ledger (though it may have reported expenditures of savings or identified projects on which savings were expended via Form SAB 50-06).

Criteria

Education Code Section 17076.10 (a) states in part that “A school district that has received any funds pursuant to this chapter shall submit a summary report of expenditure of state funds and of district matching funds annually until all state funds and district matching funds are expended, and shall then submit a final report to the board.”

Education Code Section 17070.63 (c) states that “Any savings achieved by the district’s efficient and prudent expenditure of these funds shall be retained by the district in the county fund for expenditure by the district for other high priority capital outlay purposes.” Furthermore, SFP Regulations section 1859.103 states that “A district may expend savings not needed for a project on other high priority capital facility needs of the district....”

Education Code Section 41010 states in part that “...The accounting system used to record the financial affairs of any school district shall be in accordance with the definitions, instructions, and procedures published in the California School Accounting Manual (CSAM) as approved by the State Board of Education and furnished by the Superintendent of Public Instruction.”

The California School Accounting Manual (CSAM) Procedure 105, states in part that “... A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. The principal role of funds is to demonstrate fiscal accountability. The financial

transactions of LEAs are separated into various funds in order to permit administrators to ensure, and report on, compliance with the laws and regulations that affect LEAs.”

Recommendation

The district should complete all postings and activities for the 16 identified projects and then complete the savings expenditure procedure and reporting for the remaining 87 identified projects reporting savings. The district should ensure the audit trail and supporting documentation for savings expenditures are maintained and available for future audits.

The district should also ensure that LAUSD Staff are aware of and understand the proper procedures for identifying, tracking, and reporting expenditures of project savings. These reports should be reviewed on a periodic basis by executive management.

Staff intends to follow-up with the district on June 30, 2010 to ensure that the project savings have been clearly recorded and accounted for.

Finding 2

In Fiscal Year 2005-06, LAUSD transferred \$3,895,000 from County School Facilities Fund 1A (Funds received from State Proposition 1A) to Debt Service which is the account title in the financial statements. The \$3,895,000 was transferred by two journal entries for \$3,470,500 and \$424,588 dated February 2, 2006 and June 13, 2006, respectively. The transfer was to a sinking fund for a local bond issue. In the same year, LAUSD transferred \$2,629,000 from the State School Building-Lease Purchase Fund to pay local debt service. These transactions amount to the misuse of State bond funds.

Criteria

For County School Facilities Fund

SFP Regulations Section 1859.79.2 state that “The Modernization Grant plus any other funds provided by these Regulations shall be expended as set forth in Education Code Sections 17074.25, 17074.10 (f) and 17070.15 (f)...” and “Modernization funding, with the exception of savings, is limited to expenditure on the specific site where the modernization grant eligibility was generated.”

Education Code Section 17074.25 states that “A modernization apportionment may be used for an improvement to extend the useful life of, or to enhance the physical environment of, the school. The improvement may only include the cost of design, engineering, testing, inspection, plan checking, construction management, demolition, construction, the replacement of portable classrooms, necessary utility costs, utility connections and other fees, the purchase and installation of air-conditioning equipment and insulation materials and related costs, furniture and equipment, including telecommunication equipment to increase school security, fire safety improvements, playground improvements, the identification, assessment, or abatement of

hazardous asbestos, seismic safety improvements, and the upgrading of electrical systems or the wiring or cabling of classrooms in order to accommodate educational technology....”.

For the SSB-LPP Fund

Education Code Section 17036(a) states “...Except as provided in subdivision (b), funds may be expended from the county school lease-purchase fund by the applicant school district only when specifically authorized by the board for either direct project costs or reimbursements.”

Recommendation

LAUSD should return \$3,895,000, plus interest, inappropriately transferred to pay local debt service to the County School Facilities Fund 1A. LAUSD should return \$2,629,000, plus interest, inappropriately used to pay local debt service to the SSB-Lease Purchase Fund, for a total of \$6,524,000. The District should ensure that staff possesses a clear understanding of the SFP Regulations and Education Code requirements pertaining to the proper use of SFP and LPP apportioned funds.

OPSC Evaluation of LAUSD Response

On March 10, 2010, LAUSD provided a written response to OPSC's draft report. That response is presented in the following pages.

The OPSC has reviewed the response provided by LAUSD. The reference on page 1, paragraph 4 was to SFP Regulations; it should have been to the California Education Code. The final report is amended to reference California Education Code section 17076.10 (a) which requires annual submission of expenditure reports until all state and district matching funds are expended. LAUSD, in their concurrence with Finding 2, noted a different amount based upon the Comprehensive Annual Financial Report for 2006. The basis for the figures used by OPSC is two journal entries provided by LAUSD staff.



Los Angeles Unified School District

Facilities Services Division



OFFICE OF THE SUPERINTENDENT

FACILITIES SERVICES DIVISION

March 10, 2010

Steve Inman, Audit Supervisor
Office of Public School Construction
1130 K Street, Suite 400
Sacramento, CA 95814

RE: OPSC Draft Final Audit Report

LAUSD staff thanks the OPSC for preparing and providing to us a draft copy of the OPSC Report on the Los Angeles Unified School District Reporting and Application of Project Savings dated December 2009. Additionally, the District appreciates the OPSC's willingness to grant an extension on the deadline to provide feedback since this allowed LAUSD staff to provide constructive comments on the content of the report.

After review of the draft copy of the report, the LAUSD concurs with the substance of the recommendations, but does not concur with many of the statements made throughout the draft report. The LAUSD staff believes that many of statements declared in this document do not convey a balanced or neutral representation of the facts in this review. The LAUSD believes that if the attached responses are incorporated into the final report, the final product will better represent the information provided during the audit.

Additionally, the LAUSD has added information on its progress towards completing the District plans that were shared with OPSC auditors during their on-site reviews. We believe that the plans shared with OPSC auditors will, once completed, satisfy the recommendations made in the report.

The District looks forward to receiving a final report that incorporate LAUSD recommended edits.

If you have any questions or need additional information, please contact me at shawn.atlow@lausd.net or (213) 241-4889.

Thank You.

A handwritten signature in black ink, appearing to read "Shawn", followed by a stylized flourish.

Shawn Atlow, Acting Director
Facilities Legislation, Grants and Funding

Attachment

BACKGROUND

Page 1, Paragraph 4:

The draft report states *"Per SFP Regulation Districts or Local Education Agencies (LEA) must report the application of those savings to the OPSC annually until all project savings, State and District shares, are fully expended."*

The LAUSD would like to clarify that this statement is not supported in SFP Regulations, but rather this statement is referenced in the School Facility Program – Substantial Progress and Expenditure Audit Guide, May 2008 version. The regulations governing Program Reporting Requirements pertaining to savings can be found in Regulation Sections 1859.103 and 1859.104. Neither regulation establishes a requirement in which a school district shall report savings on an annual basis. Additionally, there isn't a regulation, other than financial hardship, that governs when savings shall be expended.

Therefore, the District would ask that this statement be clarified in the final report to reflect the proper source and incorporate the program reporting requirements stipulated in Regulation Section 1859.104.

Page 1, Last Paragraph and carried over to Page 2:

The paragraph identifies the number of projects under review and the approximate savings generated from those projects. The paragraph continues by describing the difficulties the OPSC had with scheduling meetings and gathering the appropriate types of information to conduct the savings audit. In its entirety, the tone of this paragraph suggests the LAUSD was uncooperative and intentionally not providing requested documentation. The District does not concur with this representation of the facts.

This paragraph has been placed in the Background Section of the report and the District believes this section should include a reference to the newly instituted audit policy and procedures. It was during this time the OPSC revealed the new protocols to the District. These new protocols had not been previously publicized and school districts were unaware of the OPSC expectations at that point in time. Absent the appropriate context, the words used in this paragraph would imply there is an ongoing process and/or an established set of expectations the LAUSD should have already been aware of.

Terms and/or phrases such as "OPSC *continued* to provide time extensions" or "the information provided was *difficult* to understand" or simple words like "*unproductive*" make it appear the LAUSD was doing something inappropriate and not following an established set of policies or procedures. The context that a reader needs to understand is that this savings audit was a learning experience for both the OPSC and the District. Statements used above would be more appropriate if such a process was in place for several years and school districts were fully aware of what was expected of them.

The District would ask that language similar to the following be incorporated into the final audit report: "The timing of submittal of those expenditure reports coincided with OPSC's implementation of new audit protocols and prompted requests for information beyond the expenditures for which savings had been applied. The provided financial information was difficult to analyze using off-site audit practices so the OPSC conducted a follow-up visit with the district on February 4, 2009."

SCOPE AND OBJECTIVE

In review of the statement, the LAUSD feels that it would be appropriate to maintain consistency and specify the objective of the audit as it was stated during the July 2009 Audit Entrance Conference. The stated audit objective at that time was as follows:

- Determine accuracy of SFP savings accounting
- Determine appropriateness of interest allocation
- Determine whether required district contribution was made
- Determine whether reported expenditures were allowable and supported
- Establish reliable audit trails to facilitate audit of more projects

Attachment

- Document the district's internal controls

The District would ask that the above mentioned bullet points be incorporated into the final report.

RESULTS

Page 2, Last Paragraph:

The District believes the Results Section was drafted in a rather brief manner that was void of any detail explaining what the District has been doing to account for the savings or why it was accounting for savings in the manner it was.

As a point of clarification, the LAUSD would like the report to reflect that the postings for the 16 projects were completed by the time the review was concluded. During the on-site audit, the District provided to OPSC auditors evidence, in the form of data from the LAUSD's General Ledger, that all postings related to the 16 reviewed projects were complete.

The District would ask that the following be incorporated into the report as we believe this fully reflects the actions of the District and provides more detail as to the decisions and actions made by the LAUSD:

Historically, savings were maintained in the same General Ledger accounts created to manage all other SFP funds. District staff indicated that the savings expenditure reports were generated using the information from the General Ledger in conjunction with off-line reports that indicated the connection between projects that generated savings and those projects that used savings.

In order to more effectively report accumulated savings during the audit, the District created separate General Ledger accounts for savings and began populating the accounting system with the raw data. The postings for the 16 projects that were reviewed during the on-site audit were complete by the time we concluded our review. The District goal for completing the task to populate the newly created General Ledger accounts with the accumulated savings for the remainder of the 103 projects is December 2009.

At the conclusion of the OPSC review, the LAUSD had not spent the savings from the remaining 87 projects.

Review of prior year's Comprehensive Annual Financial Report, which included the results of annual independent audits, disclosed inter-fund transfers involving revenues from State grants. These transfers are discussed in the second finding.

FINDING 1

The report states *"Until early 2009, the LAUSD did not have a procedure in place for identifying uses of project savings, tracking savings expenditures, or reporting uses of savings."*

The District would concur that it did not have a formal procedure for identifying uses for SFP savings; however the District had procedures in place for tracking savings expenditures and reporting uses of savings and would ask that this be corrected in the final report. The issue at hand is that the LAUSD procedures were not acceptable to the OPSC staff. Again, the audit protocols that are being applied today are new for both the OPSC and the LAUSD and shall provide school districts with a framework to better understand the expectations that the OPSC has for school districts and we look forward to continuing this dialogue.

RECOMMENDATIONS

The report states *"The district should complete all postings and activities for the 16 identified projects and then complete the savings expenditure procedure and reporting for the remaining 87 identified projects reporting savings."*

As stated earlier, the District completed the postings for the 16 identified projects by the completion of the audit review. Therefore, the recommendation should only reflect the need to complete all postings and activities for the accumulation of all declared savings and then complete the savings expenditure procedure and reporting for

Attachment

the remaining 87 identified projects. For the remaining 87 projects, the District continues to execute its process for posting savings to the accounts for those funds. The LAUSD will submit expenditure reports to the OPSC after the funds have been expended. While LAUSD has declared SFP savings, there is no statutory or regulatory time limit for expenditure of those funds.

The recommendation also states "Staff intends to follow up with the District on June 30, 2010..." The District would respectfully request that OPSC Staff follow-up with the District be complete by mid June 2010. This will better accommodate District accounting staff that will be unavailable for several weeks, starting in June, while they work to close the books for the 2009-2010 fiscal year.

FINDING 2

The report states "In Fiscal year 2005-06, the LAUSD transferred \$3,895,000 from the County School Facilities Fund 1A to Debt Service which is the account title in the financial statements."

The District would like to clarify the funds that were transferred were \$3,046,000 and not \$3,895,000 as reported. The District would also like to clarify that LAUSD always planned and still intends to return those funds to the accounts from which they originated. Finding 2 characterized a transfer as a "misuse of funds" rather than an inappropriate transfer. The term "misuse" implies that the LAUSD spent revenues from state sources on ineligible costs and does not accurately reflect the intended temporary nature of the transfer.

CRITERIA

This Section identifies Education Code and School Facility Program regulation related to the finding that the LAUSD made an inappropriate transfer of state bond funds. In review, LAUSD staff discovered that a relevant regulation was absent from the report - Regulation Section 1859.90.1 – Local Bond Reimbursement Fund Releases.

Regulations Section 1859.90.1 states that "When a school district uses local bond funds to make eligible project expenditures...and state school bonds funds are made available to reimburse the state's share of those eligible project expenditures, the reimbursement funds shall be used... (a) Toward retiring the local bonds; and/or (b) Toward uses permitted by the local bond, or (c) For any high priority capital outlay expenditure in the district as permitted in Education Code Section 17070.63(c)."

During the on-site audit, LAUSD staff informed OPSC auditors that the \$5,675,000 in transfers to the debt service account are temporary transfers intended to guarantee QZAB bond issues until such time that anticipated SFP revenue for approved QZAB projects were received by the District. District staff further explained that the LAUSD always planned and still intends to return the referenced funds to the accounts from which they originated.